



30 March, 2005

Mr. Gary M. Jackson

Assistant Administrator for Size Standards
409 Third Street, SW.
Washington, DC 20416

Subject: Comments to Advanced Notice of Proposed Rulemaking (ANPRM) re: *the participation of businesses that are majority-owned by venture capital companies in the Small Business Innovation Research (SBIR) Program.*

Reference: Federal Register, Volume 69, number 232

Dear Mr. Jackson;

KOR Electronics is a venture capital backed Defense Electronics small business and SBIR program participant. Per the instructions of the subject matter we are pleased to provide our inputs to your query.

Prior to addressing the seven items that you are seeking information on we would like to give some brief information on KOR Electronics and the Venture Capitalist that have invested in our firm.

First, the venture capital investment in KOR Electronics is purely at the professional level. Our investors are straight forward investment corporations and not a subsidiary or investment wing of a larger parent corporation. Their investors consist of individuals, retirement funds, pension funds and other institutional large scale funds. As investors, they are identified as Limited Partners to the venture fund in which they are invested. As Limited Partners they have no direct or indirect contact or influence with the companies contained in fund's portfolio. They also do not receive information on the internal operations of the companies within the portfolio. This is analogous to the concept of mutual fund investments. There is no other benefit to these investors other than a gain or loss on their investment.

Second, the primary goal of our venture capital investors is to have their investment grow. To this end they fully understand the important role that IR&D and new product development play in driving company growth. Therefore a lot of emphasis is placed on expanding technologies through company investments as well as any customer funded source. Because of this we have always considered the SBIR programs as a way for us to expand our technology into an area of government interest. We have never in the past, nor plan to going forward, view any SBIR program as a source of profitability. In fact we have

always considered these opportunities as something that the company is willing to co-invest in as we have done on a number of occasions.

The following are our responses to the itemized issues that the SBA has requested information:

1. The role of VCC financing on SBIR projects during Phases I and II.

Response: It is our experience that VCC financing plays no direct role on SBIR projects during Phases I and II. Indirectly, VCC financing is usually used to help grow a company. This is typically through technology enhancements which coincide with the purpose of the SBIR programs.

2. The impact of such a change in eligibility requirements on the composition of SBIR participants. For example, would the program shift towards lower-risk technologies closer to market, or become more geographically concentrated following industries and areas of venture capital focus?

Response: We feel that a change in the eligibility requirements would tend to stifle the higher end innovative research and result in lower technology solutions or more theoretical than practical solutions.

3. The types of firms and projects that would benefit most from such a change, and those that would benefit the least.

Response: Most likely the firms that would benefit the most by restricting VCC backed companies from participating would be companies with very few research resources and thus programs that aren't wide reaching in scope. VCC backed companies tend to invest their funds into more research assets and look for broader/larger technical perspectives. We also believe that this move would potentially hinder projects that could make it to market faster as the result of the financial backing provided by VCC backed companies.

4. Whether an exclusion from affiliation for VCCs would require justifying limiting the exclusion to VCCs and not including other entities such as not-for-profit organizations.

Response: Once again it comes down to addressing the perceived problem. Specifically what is the problem and how big is this issue? We are not aware of any companies passing their research intellectual property up to larger corporations through the investment mechanism.

5. Whether or not granting VCC exclusion from affiliation would adversely affect the ability of small business concerns without such access to private capital to compete for SBIR awards.

Response: This would most likely come down to the demographics of the percentage of SBIR funds that are awarded to VCC backed companies. The thinking is that by excluding VCC backed companies there may be more funds available for non-VCC backed companies. Without knowing this data, no opinion can be presented.

6. Whether the participation of firms owned and controlled by VCC firms would ultimately create an environment of multiple repeat award winners.

Response: We do not believe this would be the case. In order for this to happen the VCC firms would have to become very active in the day-to-day operations of each of their firms and then coordinate efforts between their portfolio companies. Almost all VCC are structured with very few "partners". These are the people that actually monitor the investments in each company. Their role or involvement with the company is usually no more than attending the periodic Board of Directors meeting. The rest of their time is spent managing their fund, looking for new investors and issuing financial status of the complete fund to the limited partners. We are not sure how a professional VCC would ever approach the point of controlling matters down to this level.

7. Alternative approaches that may assist small business concerns in obtaining and utilizing VCC funding while participating in the SBIR Program, aside from a policy that requires an exclusion from affiliation for VCC majority-owned small business concerns.

Response: We believe that as long as the investors behind a VCC majority owned small business are at an arms length from the business itself this would be sufficient. Right now this would be defined as it is today. Investors are "limited partners" and there is no active participation by them with any of the portfolio companies. In this definition the term "active participation" could be broadly defined because investors in professional VCC absolutely have no control, influence, contact, or insight into the companies that their fund has invested.

In conclusion it is our opinion that the statements opposed to allowing a concern to participate in the SBIR Program if one or more VCCs have a majority ownership or control, is too broad. The direct comment from the Federal Register stated:

"These commenters expressed their concern that because VCC firms often represent and are established by large corporate interests, allowing their subsidiaries to receive SBIR awards could result in SBIR funds, which are reserved for small business concerns, being used to subsidize research projects of large corporations."

We guarantee that our past and present investors, as well as most professional level Venture Capital funds, are not established nor represent any specific investor's interest other than growing wealth. We are confident that the problem that these opponents are attempting to address is more of the exception than the rule.

Sincerely;



Kevin Carnino
CEO & President
KOR Electronics